Commonwealth of Massachusetts
Department of Telecommunications and Energy
Fitchburg Gas and Electric Light Company
Docket No. D.T.E. 02-24/25
Record Request Response

Record Request No.: AG-RR-66 (Common)
Please describe the nature of the cost for the percentage repair allowance and how it is treated for tax and book purposes.

Response:
The nature of the cost for the percentage repair allowance (PRA) is stated in Taxation of Public Utilities, Publication 791 Release 1, September 1994.

For financial and regulatory accounting purposes, expenditures for repair and maintenance costs generally are expensed as period costs. Amounts that improve the capacity of an asset or extend its useful life are capitalized and recovered through depreciation. These same general principles are followed for federal income tax purposes. One notable exception to this general rule is the "repair allowance rule" of the Asset Depreciation Range (ADR) depreciation system. Taxpayers that elected to use the ADR system of cost recovery could also separately elect to use the repair allowance rule for such property in order to determine the allowance amount of repair and maintenance deductions for the taxable year.

The intent behind the repair allowance rule was to provide a safe harbor to minimize disputes over whether specific repairs should be capitalized when the expenditure arguably increased the operating capacity or useful life of the underlying asset. Under the ADR repair allowance provision, a taxpayer could deduct costs incurred to maintain or repair eligible property for which the election had been made in an amount up to the specified repair allowance limit. Costs incurred in excess of the allowance amount or costs considered "excluded additions" (as defined by the regulations) were capitalized under the rule. The repair allowance amounts for each ADR guideline class are located in Revenue Procedure 83-35. No provision similar to the ADR repair allowance election exists under the general depreciation, ACRS, or MACRS rules.

Comment: The distinction between a repair and a capital expenditure is often unclear. The ADR repair allowance rule represented an attempt to mitigate the number of disputes arising in this gray area. While the rule indeed did reduce the problem, it by no means eliminated it. The determination of whether a particular expenditure was an "excluded addition" (e.g., whether the expenditure represented an additional "identifiable unit of property," whether it substantially increased the productivity or capacity of an existing identifiable unit of property, or whether it replaced an existing identifiable unit of property) itself generated a considerable number of controversies during the life of the ADR depreciation regime."

For book purposes, PRA assets are footnoted and receive no special treatment. For tax purposes, the PRA amounts are subtracted from the current year plant asset balances and then amortized over a period of 26 years. PRA is taken when assets with a vintage year of 1982 or older are replaced with the same or like assets.

Person Responsible: Mark H. Collin